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Michigan Tobacco Enforcement

Michigan Department of Treasury

History

Michigan has levied an excise tax on cigarettes since 1947. After decades of being assessed at or below 25 cents per pack, Michigan's Cigarette Tax was increased to 75 cents per pack, as part of the implementation of Proposal A in 1994. Since that time, the per-pack Cigarette Tax has been increased twice, to \$1.25 in 2002 and \$2.00 in 2004. Michigan's Cigarette Tax is now one of the five highest in the nation.

Master Settlement Agreement

In November 1998, 46 states, including Michigan, reached an agreement with four major tobacco companies to settle lawsuits relating to the public costs of treating smoking-related illnesses. This agreement was entitled the Master Settlement Agreement or MSA. The MSA provided for annual payments from the four tobacco companies, to the states, with payments totaling more than \$206 billion by 2025. Michigan received an initial payment of \$107.5 million in December of 1999, with Settlement payments totaling \$1.54 billion through 2004. Annual payments will continue in perpetuity with Michigan scheduled to receive more than \$8.5 billion by 2025. In 2006, Michigan also received \$491 million through the sale of taxable bonds in exchange for 13.4 percent of whatever it receives in the future as part of the agreement.

Cigarette Tax Avoidance

Higher cigarette taxes, and higher costs per pack, have led many smokers to seek alternatives to purchasing taxed cigarettes. The Michigan Department of Treasury has teamed with other state and federal agencies as well as non-government entities in an effort to educate the public with regards to tobacco laws and to combat various forms of tax avoidance.

As part of its ongoing educational efforts the Department is utilizing different means to remind Michigan purchasers that cigarettes not bearing a valid Michigan stamp violate Michigan's Tobacco Products Tax Act (TPTA) and that control or possession of such cigarettes subject them to not only the tax but 500 percent penalty as well. This includes cigarettes purchased over the internet, or from any other source within or outside the state, unless the purchaser or seller is licensed under the TPTA as a stamping agent and complying with the Act by stamping each individual pack, collecting the tax due, and remitting the appropriate tax revenues to the state. Such sales also frequently violate federal laws such as the Contraband Cigarette Trafficking Act and the Jenkins Act. Prior to 1994, the differential between Michigan's Cigarette Tax and rates in other states was minimal and did not lead to large-scale efforts to buy or sell untaxed cigarettes. However, the incentive to avoid taxation in Michigan became much stronger after the 1994 Cigarette Tax increase took effect. Additional increases imposed in 2002 and 2004 have resulted in even more effort regarding cigarette tax avoidance and evasion. In response to the increased incentive to avoid tax and other tobacco laws, the Department continues to review and refine its enforcement efforts.

Enforcement Programs & Initiatives

Department of Treasury Tobacco Enforcement Actions

Michigan purchasers do not have to physically leave the state to illegally purchase cigarettes and avoid payment of cigarette taxes. A form of illegal cigarette smuggling is conducted through mail order and/or Internet sales. In these situations, the seller obtains low-tax or untaxed cigarettes and then sells and ships them to Michigan residents or businesses without the appropriate Michigan stamps and taxes. Recent growth in e-commerce has led to an increase in such Internet-based sellers who advertise and sell so-called "tax-free" cigarettes.

The Michigan Department of Treasury has taken several steps to curtail this and other practices, in order to collect Cigarette Tax revenues rightly due the state. As part of its Tobacco Enforcement Action Plan, Treasury sent notices to all newspaper publishers in Michigan (Oct. 2004) educating them as to the provisions of the Tobacco Product Tax Act. Treasury has also contacted specific advertisers where such advertisements have come to the attention of the Department.

Treasury has also been contacting individual purchasers in order to collect unpaid taxes and penalties. To date, over 20,000 individuals have been contacted with total liabilities exceeding \$20 million. These mailings will continue as additional information is obtained and processed.

To help educate Michigan residents regarding the various tobacco-related statutory provisions, including restrictions on the purchase and possession of non-stamped cigarettes, the Department of Treasury has issued a number of press releases over the last several years. These releases also provide additional detail regarding enforcement efforts and direct citizens to Tobacco Tax information located on Treasury's Web site which can be directly accessed at www.michigan.gov/tobaccotaxes .

Should a Michigan purchaser become aware that they have acquired cigarettes without Michigan stamps/taxes, Treasury has provided forms with which taxpayers can send in the Tobacco and Use Taxes that should have been paid. By promptly doing so, these individuals can avoid costly penalties that would otherwise be due.

Department of Treasury Interaction with Michigan Indian Tribes

Cigarette sales by retail stores located within a tribe's "Indian Country" pose a unique enforcement problem for states, given the attributes of sovereignty possessed by federally recognized Indian tribes. To address this and other related issues, the Department of Treasury has committed significant time and resources toward establishing relationships with the various Michigan tribes and developing specific protocols to help guard against the inappropriate distribution of untaxed cigarettes. These efforts, with the assistance of many of the tribes, have resulted in a significantly enhanced enforcement regime.

A specific example of such effort was the Department-led negotiations with the federally recognized tribes located in Michigan, where the State and the Tribes got together in an effort to obtain broad tax agreements that address a variety of taxes, including tobacco. This two year process resulted in agreements with eight of the twelve tribes (Bay Mills Indian Community, Grand Traverse Band of Ottawa & Chippewa Indians, Hannahville Indian Community, Little River Band of Ottawa Indians, Little Traverse Bay Bands of Odawa Indians, Nottawaseppi Huron Band of Potawatomi Indians, Pokagon Band of Potawatomi Indians, and Sault Ste. Marie Tribe of Chippewa Indians). These agreements cooperatively ensure the collection of Michigan tobacco taxes by providing specific protocols for sales within "Indian Country" as well as enforcement provisions allowing the State to audit and inspect within these sovereign lands.

With regards to those tribes which do not have an agreement with the State (Keweenaw Bay Indian Community, Lac Vieux Desert Band of Lake Superior Chippewa Indians, Match-E-Be-Nash-She-Wish Band of Potawatomi Indians, and Saginaw Chippewa Indian Tribe), the Department of Treasury continues to monitor and enforce State tax laws, to the extent allowed by federal law. These efforts have resulted in a number of cigarette seizures and a considerable amount of

litigation. To date, the State has prevailed in all such litigation with the most recent decision coming from a U.S. District Court specifically upholding the Department's established protocols.

Tobacco Tax Team

Since the enactment of the Tobacco Products Tax Act in 1994, the Michigan State Police Tobacco Tax Team has undertaken a cooperative effort to enforce the laws, in conjunction with Michigan Department of Treasury, Michigan Attorney General, and Department of Community Health staff. As a result of this effort, within the first eight months the *Act* was in effect, more than 44,000 cartons of cigarettes, with an estimated value of \$800,000 were seized. The tax due on these cigarettes was in excess of \$330,000. More than \$225,000 in cash was also seized during these early investigations. In total, since the inception of the *Act*, the Tobacco Tax Team has seized more than 280,000 cartons of untaxed cigarettes and about 66,000 units of Other Tobacco Products resulting in more than \$8 million in tax and penalty assessments by the Department of Treasury. In addition, the value of the product seized is in excess of \$8 million and there have been over 500 related arrests to date.

Non-Participating Manufacturer (NPM) Enforcement

The Master Settlement Agreement (MSA) provides for reductions in payments from participating manufacturers *if* they lose market share to Non-Participating Manufacturers as the result of a state's failure to enact and diligently enforce a Model Statute designed to neutralize "cost disadvantages" a participating manufacturer experiences in relation to NPMs. In December 1999, Michigan joined other states in addressing this issue by enacting Public Act 244. This law requires NPMs to establish and maintain a qualified escrow fund, if they sell cigarettes (including roll-your-own tobacco) for ultimate consumption in Michigan. Escrow funds are maintained for 25 years to pay judgments or settlements on claims against the NPM, brought by the state or "releasing parties" as defined in the MSA. Shortly after enactment of PA 244, the Department of Treasury identified potential NPMs and mailed to them notification of the new law and its escrow requirements.

As an important step in ensuring NPMs comply with this statute, Michigan statute also requires licensed tobacco wholesalers and unclassified acquirers to report to the Department all NPM tobacco products and quantities purchased for consumption in Michigan. Those NPMs determined not to be in compliance with the various escrow requirements are referred to the Michigan Attorney General, who may then bring civil action against the NPM.

Enforcement of Requirements for Non-participating Manufacturers

	2000	2001	2002	2003	2004	2005
Contact with known or suspected NPMs	41	86	108	98	49	11
*NPMs whose products were reported as sold in MI	35	27	46	44	28	10
NPMs depositing funds in qualified escrow accounts for MI	11	15	23	20	18	8
Total deposited in qualified escrow accounts for MI	\$267,756	\$342,439	\$1,007,888	\$1,633,704	\$922,484	\$1,508,664
**Cases referred to Michigan Attorney General	6	6	10	15	3	TBD

* Some NPMs included in this number may later have been found to be incorrectly reported. This number can vary.

**These numbers may include multiple years for a single NPM and for 2004 additional investigations are pending.

Since 2001, the average annual amount deposited into NPM escrow accounts has nearly tripled with accounts for Michigan now holding almost \$5.7 million. Treasury referrals to the Attorney General are also beginning to reflect this increase in compliance.

For sales in calendar years 2000 through 2005, the Department has sent 393 letters to known or suspected NPMs whose cigarettes (including 'roll-your-own' tobacco) may have been sold for consumption in Michigan. Additional letters will be sent where new NPMs are found to have their products sold for consumption in Michigan. As the number of letters continue to decrease due to improved methods of identifying NPMs, existing resources are able to focus more and more on the remaining accounts.

To date, the Department has referred 40 cases to the Attorney General for legal action which have resulted in 18 court judgments (with additional cases pending).

Continuing NPM/Tobacco Tax Enhancements

The Department of Treasury is continually looking for ways to improve its tax systems and other areas of responsibility. Given the disparity of state tax rates and the MSA responsibilities, the administration and enforcement of the TPTA and the various issues related to NPMs are of particular importance. Current and future initiatives are outlined below:

- PA 327 of 1993 was amended effective July 18, 2002, requiring certain tobacco licensees to report acquired NPM product to the Department. It also requires

NPMs to file an annual certification attesting to their compliance with escrow requirements as well as provide important information including brand identification. Enforcement was further strengthened by prohibiting acquisition or sale of non-compliant NPM product, and through extending fines, penalties, and seizure provisions to NPM products.

- PA 327 of 1993 was amended again on January 8, 2004, requiring Non-participating manufacturers to pre-pay an Equity Assessment fee of at least \$10,000 prior to commencing tobacco sales for consumption in Michigan. Since the passage of this bill the number of letters sent to believed Non-participating manufacturers has decreased from over 108 to 11. The bill also requires that all non-participating manufacturers report the brand names of the cigarettes (including roll-your-own) that will be sold for consumption in Michigan. With the pre-payment provisions and other enforcement tools, this amendment has helped to reduce the rate of non-compliance from approximately 69% for 2000 sales to 20% for 2005 sales. As does the 2002 amendment, the bill also provides for the posting on Treasury's Web site of the non-participating manufacturers who have complied with our laws and are able to have their approved tobacco product brands shipped into Michigan. Likewise, the purchase for consumption in Michigan of tobacco product brands not found on the list, or any tobacco product manufactured by a NPM that is not found on the list, is a violation of the act by the seller and the purchaser and subjects them both to fines, penalties, and other State action.
- A Listserve was established after receiving feedback from licensees. This listserv is used to communicate information such as changes to the Web site list, notice of judgments, and other useful information, to anyone wishing to sign up for such services.
- The www.michigan.gov/tobaccotaxes Web site was established to further assist licensees by providing the latest tobacco tax information. Links are provided to the Tobacco Products Tax Act, PA 327 of 1993, and other laws that pertain to tobacco taxes. The Web site houses the list of NPMs and their brands that are authorized for sale and consumption in Michigan. A link to the www.naag.org Web site is also provided so tobacco licensees are able to identify participating manufacturers in good standing and from whom they may buy product.
- The biggest deterrent to counterfeit cigarette sales in Michigan is the State's tobacco tax stamp program which makes it much easier to identify contraband cigarettes. To help ensure the effectiveness of this program, various security features incorporated into the stamps (including color) are changed routinely.

- A Tobacco Tax Tip Hot Line has also been set up to allow concerned taxpayers to submit anonymous information regarding tobacco tax violations. These tips are forwarded to the Treasury Enforcement Team, whose primary duty is the enforcement of the Tobacco Products Tax Act.
- System improvements have also increased efficiency and accuracy regarding tobacco related record keeping and processing (including those associated with non-participating manufacturer information). Additional staff has also been assigned to this area.
- Treasury also works closely with the Michigan State Police and the Office of Attorney General to provide for more effective tobacco inspections and other necessary enforcement activities.
- Public Act 474 of 2004 also enhanced section 11 of the Tobacco Products Tax Act (MCL 205.431), which **makes it illegal to sell or solicit a sale of a tobacco product to be brought into Michigan to anyone other than an appropriately licensed person (manufacturer, wholesaler, unclassified acquirer, etc.), by adding a variety of new provisions.** The new provisions, among other things, require that packages containing tobacco products be properly marked and that detailed seller information be included on invoices and other such paper work, both of which aid the State's enforcement efforts.
- The Department of Treasury also offers ongoing education to tobacco tax licensees to help assure compliance with regards to the State's various tobacco requirements.
- Treasury has also implemented an Automated Tobacco Products Tax System which allows the department to better monitor the distribution of tobacco products at all levels. This will also help the Enforcement Team to more easily identify violations of the Tobacco Products Tax Act. In addition, the new system will aid in the monitoring of inventory levels of both tobacco and cigarette stamps at the wholesale level thus providing for increased accuracy and efficiency regarding ultimate reconciliation of usage and sales. Finally, this system gives the Enforcement Team the ability to view information electronically thus providing easier and quicker identification of possible violations of tobacco laws and subsequent enforcement action.

Conclusion

The State of Michigan has taken extensive action to administer and enforce the Tobacco Products Tax Act as well as PA 244 of 1999 which ensures that tobacco

product manufacturers participating in the Master Settlement Agreement are not put at a cost disadvantage. The State is committed to the enforcement of its tobacco laws and will continue to review and modify its efforts as new information and circumstances present themselves.